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Supreme Court, U.S.
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No. 00-699

In The
Supreme Court of the United States

HOWARD GREENBERG,
Petitioner,

v.

BEAR, STEARNS & CO.,
BEAR STEARNS & CO., INC.,
BEAR STEARNS SECURITIES CORP.,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITIONER'S REPLY BRIEF

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POINT I

CERTIORARI SHOULD BE GRANTED TO DETERMINE THE CORRECT STANDARD FOR REVIEW OF ARBITRATIONS UNDER THE FEDERAL SECURITIES LAWS.

Respondents' brief in opposition did not dispute that there is no standard as to what manifest disregard means. Nor did the respondents' brief discuss the desirability of having a standard which at least guaranteed that a reviewing court with respect to the federal securities laws could assure the parties that the basics of those laws had been applied.

As this case now stands, it is not an exaggeration to say that this case demonstrates that no law governs securities transactions before arbitrable forums. For this case shows that no matter how egregious and clear the violation, if three arbitrators in the industry-controlled forum decide there was no violation, that is the end of the matter.

Contrary to respondents' attempts to make this case look like an ordinary factual dispute in which reasonable men may differ, this case is about imputed knowledge as a matter of law.[1] The doctrine of imputed knowledge is admittedly totally accepted in the securities area. (See cases cited, p. 15 of petition to this Court.) Respondents' response to this is that:

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[1] Respondents first discuss this at page 13 of their brief. Point II of this brief will deal with respondents' "facts".

> The arbitrators did not manifestly disregard the securities law by refusing to impute knowledge to Bear Stearns. They simply credited the testimony of Bear Stearns' witnesses. (pp. 13, 14, respondents' brief)

That statement turns imputed knowledge on its head. The doctrine of imputed knowledge holds that as a matter of law, when a person or party is given certain facts in certain circumstances, that party is held to know them regardless of any testimony to the contrary. "The means of knowledge are the same thing in effect as knowledge itself." Dodds v. Cigna Securities Inc., 12 F.3d 346, 351 (2d Cir. 1993).

Moreover, the testimony was not even to the contrary, for the one witness (Brigley) who admitted to having seen the prospectus and who had admittedly read the first sentence of the one critical paragraph, said he could not "recall" reading the third sentence which would have clearly informed him of the lockup and the fraudulent misrepresentations. Thus, Brigley, when asked whether he had read the third sentence, stated at page A 138 (the page cited by respondents' brief at pages 3-4 for the proposition that "Bear Stearns' witnesses . . . did not read the technical language . . ."):

> Again, I don't know if I read it back then or remember reading it back then, but I certainly have seen it in subsequent times having to give testimony. (A 138, at p. 263)

Asked again about the third sentence Brigley stated: "I don't recall." (A 138, p. 264).

Not only did Brigley have this paragraph before him, but a Bear Stearns lawyer who drafted a personal guarantee

agreement from Sterling Foster's President with respect to this transaction, also had this page. Brigley testified that this lawyer wanted to know:

> where was the access of two million shares offered in the after market for selling security holders, so we sent that to her so she would have that page and the front page. (A 138)

In addition to these two people having this one paragraph, the number 2 managing director, Peter Murphy, was also shown this paragraph. Murphy couldn't "recall" anything about a lockup and the lawyer was not allowed to testify by the arbitrators over objection by claimant's attorney. Thus, if ever there were a case which required holding a company such as Bear Stearns liable for imputed knowledge, this is that case.

Respondents, in answer to petitioner's statement that the Second Circuit cited no authorities or gave any reasoning to support the conclusion that "it is by no means clear that the doctrine of imputed knowledge applies in this context", state:

> But the Petition simply ignores explicit case law (which Bear Stearns cited in its appellate brief) holding that knowledge of documents' contents should not be imputed to a financial entity performing high volume processing functions like those performed by clearing firms. See Woods v. Bank of New York, 806 F.2d 368, 369 (2d Cir. 1986)." (underlining added)

The problem with respondents' contention is that Bear Stearns cited to the Second Circuit only one inapplicable case

(Woods) and Bear Stearns was not performing a high-volume clearing function with respect to this case. As noted, Bear Stearns had asked for and examined the one applicable paragraph in the prospectus and obtained a personal guaranty from Sterling Foster's President with respect to this transaction. (A102, 200, 203) Thus, this was not a case involving massive documents flowing electronically through Bear Stearns, but was a carefully examined situation in which there was full discussion over this one paragraph in the prospectus.

Clearly, the Second Circuit did not cite Woods v. Bank of New York, supra, (the only case in respondents' brief to the Second Circuit on this Point) because it is so readily distinguishable and inapposite. The introductory paragraph in that case states:

> We . . . believe instead that to require a bank acting as transfer agent to look for notations on checks - - beyond those essential to its own requirements - - severely restricts the bank's everyday business by clogging the fast flow of information it must possess. Id. at 369

That case involved a notation on a check to put money into a particular fund. The court noted that the Bank of New York Mutual Fund made 45,000 payments per week in which clerks handled one payment every three minutes. Bear Stearns was not dealing with thousands of documents, but with one document, with one applicable paragraph in that document which at least one senior management member admitted reading in part.

Once Bear Stearns is deemed to have knowledge, Bear Stearns would be liable for participating in a fraudulent

scheme. Respondents' assertions that Bear Stearns had no duty to disclose is entirely irrelevant because it is basic law that if a party participates in its own self-created fraudulent scheme, it is that participation which imposes liability under the securities laws, not any duty to disclose. See U.S. v. Russo, 74 F.3d 1383. 1391, 1392 (2d Cir. 1996), cert. den. 117 S.Ct. 293.

As to the lack of disclosure in the confirmation of either the profit or the underwriting transaction, respondents say that there was no causal relationship shown for plaintiff's damages. This again is untrue because even the dumbest investor would understand that a 400% profit by a broker might be cause to worry. And, of course, knowledge of this 400% profit is imputed on the basis of the information available to Bear Stearns' managing director, who admittedly knew the price at which the stock was being sold to the public and who processed the sales to Sterling Foster by the selling shareholders at $3.25 a share. His denial of knowledge because he didn't do the math (dividing 1,000,000 into 3,000,000) should not pass muster under the doctrine of the imputed knowledge.

With respect to the failure to deliver a prospectus, respondents do not deny that Bear Stearns, in sending the confirmations in the first place, acted unlawfully since it is unlawful on a new issue to send any confirmation without a prospectus. Thus, this is not a question of delegation or contract law, but, rather, basic federal securities law. From that admitted violation everything else flows.

The courts so far, applying no articulated standards, have upheld this arbitration award. To say that the court will review for "manifest disregard" without any articulation of its meaning and where the result shows a failure to follow basic

federal securities law, renders meaningless petitioner's rights under the securities acts. Respondents' citation of First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 115 S.Ct. 1920 (1995) is not contrary to petitioner's argument because First Options merely cited Wilko v. Swan, 346 U.S. 427, 436-37, 74 S.Ct. 182 (1953) stating "parties bound by arbitrators' decision not in 'manifest disregard' of the law." Id. at 942; 1923. First Options never discussed the meaning of manifest disregard, much less its applicability to the securities laws.

Respondents also assert that the matters raised by petitioner "should be addressed to the SEC and the SROs, not this Court." (p. 10). But that is directly contrary to the promise made in Shearson/American Express v. McMahon, 482 U.S. 220, 232, 107 S.Ct. 2332, 2340 (1987) that there would be at least limited judicial review of arbitrations. Each individual shareholder is entitled to the protection of the federal securities laws and can only bring a claim before an industry-created arbitration panel. Review of such arbitration panel is entrusted to the courts, not the SEC or the SROs. Petitioner's remedy, therefore, can only lie with this Court.

POINT II

RESPONDENTS' STATEMENTS OF FACTS ARE NOT ONLY IRRELEVANT, THEY ARE INCORRECT.

Respondents state (p. 3) that "Bear Stearns obtained only a preliminary prospectus prior to the ML Direct offering and therefore did not know the contents of the final document." Of course, the final prospectuses was only issued on the day of the IPO. But Bear Stearns knew the fraudulent plans in advance. Thus, Brigley testified that in August,

1996, Adam Lieberman, President of Sterling Foster, called him and told him that immediately after the IPO for ML Direct, Sterling Foster was selling short 2.1 million shares and covering by "getting the shares from the selling shareholders" (A 109, p. 48). But the preliminary prospectus showed the 12-month lockup in the third sentence on page 2 for these shares.

Bear Stearns' statement that the shares in ML Direct were properly registered in a shelf registration is an irrelevant fact (p. 4). They were clearly registered, but they were also subject to a one-year lockup. Bear Stearns' next paragraph on page 4 states that the short position was merely a "technical deficit" and that:

> Bear Stearns typically received certificates for public offering shares *after* the shares had been sold to customers; as a result, temporary short positions in such circumstances were not abnormal but routine. (p. 4, respondents' brief)

If this transaction was so normal, one must ask why respondents' employees testified as follows:

> Brigley: I told him [Richard Primavera, a managing director] Sterling Foster was going to be participating in ML Direct and that it would be a large number of shares being traded, just give him heads-up, so when he sees a short position, he does not <u>have a heart attack about that</u>. (A114, at p. 67) (underlining added)

Mr. Primavera testified that his clerk, Mr. Cohen, had informed him of "a large short position". (A 239) During the days when this stock was short before the selling security holders had actually delivered, Brigley testified that he was "monitoring this... as closely as I could" (A 118, p. 84). He testified that his immediate superior, managing director Murphy, "would want to know where we were every day, how big is the customer debits, what is the short position, what does the overall entry look like in his account." (A 118, pp. 81-82) Further, he stated that he came in early to prepare e-mails and documentation so that Murphy could transmit this information to the number 1 person at Bear Stearns' clearing, Mr. Harriton, before 8:15 A.M. This was accomplished by Brigley sending e-mails marked "URGENT" before that time to Mr. Murphy, who in turn transmitted them to Mr. Harriton (A 118-119).

In addition, as noted, Sterling Foster's president signed a personal guarantee for the transaction prepared by Bear Stearns' lawyer and Sterling Foster also was required to place an additional $3 million in funds with Bear Stearns. (A 102, 103, pp. 20-23) The above facts demonstrate that the transaction here was anything but normal.

Bear Stearns next states that it did not know about the 400% profit because Bear Stearns denied that "anyone at Bear Stearns had attempted to compute Sterling Foster's purchase price for such shares" and that such knowledge would be irrelevant because "Bear Stearns could not determine whether other consideration not mentioned in the memoranda had been paid for the shares." (Respondents' brief, p. 5) See above for failure to do math issue.

As to the possibility of other consideration being paid,

this is irrelevant because once Bear Stearns knew that there was an apparent 400% profit (the difference between the $3.25 purchase price and the $15 sale price to the public), surely Bear Stearns would at least have to ask whether any other additional consideration was given. Bear Stearns did not do that. When the known facts show fraud, one doesn't avoid liability by claiming that there might be a possibility the transaction wasn't fraudulent without at least investigating. See Whitney v. Citibank, N.A., 782 F.2d 1106, 1116 (2d Cir. 1986) holding Citibank liable when "there were red flags flying all over the place."

POINT III

RESPONDENTS' JURISDICTION SUGGESTION.

Respondents raise the jurisdiction issue as a "potential obstacle . . . to review of the main questions presented here . . . . " (P. 16). Presumably, if *certiorari* were granted, respondents would argue as they did to the Second Circuit that there is no federal question jurisdiction even though the issues raised by the initial Petition to vacate the arbitration award all involved federal securities law issues.

The two federal acts involved - the Securities Act of 1933 and the Securities Exchange Act of 1934 - give jurisdiction and exclusive jurisdiction, respectively, to the federal courts. 15 U.S.C. §§ 77v; 78aa. Yet, respondents would argue that not only did Shearson/American Express relegate investors to industry arbitration, instead of federal court, but that it also took away from the federal courts any review of such arbitrations (when the federal laws are alleged to have been disregarded) except when diversity jurisdiction happens to exist. Presumably, respondents make such argument in good faith.

It would seem that if a question of jurisdiction can fairly exist when substantial federal claims are raised to the effect that the arbitrators disregarded the federal securities laws, then this Court should grant *certiorari* to resolve this issue as well.

CONCLUSION

This case demonstrates the present lawless of securities arbitration and the failure of the courts to insure the basic rights of those entitled to the protection of the federal securities laws. *Certiorari* should be granted to set standards for the courts to review these arbitrations so as to prevent such lawlessness.

Dated: New York, New York
December 12, 2000

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